EXHIBIT E-1

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our consolidated financial statements and notes to those statements and other financial information appearing elsewhere in this report. The following discussion contains forward looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated in the forward looking statements as a result of a number of factors, including the risks discussed in "Risk Factors" and elsewhere in this report.

The following discussion and analysis gives effect to the restatement described above in the "Restatement of Consolidated Financial Statements" introductory comment to this Amendment No. 1 to Annual Report on Form 10–K/A and in Note 2 to our consolidated financial statements. For this reason, the data set forth in this section may not be comparable to discussions and data in our previously filed annual and quarterly reports.

Overview

We are a leading supplier of packet voice infrastructure solutions for wireline and wireless service providers. Our products are a new generation of carrier class switching equipment and software that enable voice services to be delivered over packet based networks.

We began shipping product to customers during the fourth quarter of fiscal 1999 and recorded our first revenues of $51.8 million in fiscal 2000 and revenues of $128.8 million in fiscal 2001, $93.9 million in fiscal 2002 and $93.2 million in fiscal 2003. Significant declines in capital spending by telecommunications service providers, and financial difficulties, including in some cases bankruptcies, experienced by certain emerging service providers, including some of our customers, caused the reduction in our revenues in 2002. In response to the unfavorable economic conditions, commencing in the third quarter of fiscal 2001 and continuing through fiscal 2002, we implemented restructuring plans designed to reduce expenses and align our cost structure with our revised business outlook. The restructuring plans included worldwide workforce reductions, consolidation of excess facilities and the write–off of excess inventory and purchase commitments.

For the year ended December 31, 2003, Qwest Communications (Qwest), Verizon Global Networks, AT&T Wireless Services and Global Crossing contributed 18%, 15%, 13% and 11% of our revenues. For the year ended December 31, 2002, Qwest contributed 42% of our revenues. For the year ended December 31, 2001, Nissho Electronics Corporation, XO Communications and Global Crossing contributed 21%, 21% and 18% of our revenues.

In 2003, the challenging business environment in the telecommunications industry continued to affect the spending by service providers for products such as those we offer. In the second half of the year, there was a trend towards increased interest and activity in the market for packet–based voice infrastructure products. While it remains uncertain as to the speed and extent of the adoption of carrier packet voice infrastructure products by large carriers, we believe that over time the market opportunity for packet voice solutions is substantial. For fiscal 2003, revenues were $93.2 million compared to $93.9 million in fiscal 2002, and deferred revenues at the end of 2003 increased to $87.0 million compared to $59.8 million at the end of 2002. In 2003, we had a lesser concentration of customers. In 2002, one customer represented 42% of revenues due to the deferral of revenue on product shipped during 2001. The related deferred revenue was recognized as revenue in 2002 upon the delivery of a specified software release in the second quarter of 2002.

We sell our products primarily through a direct sales force and, in some markets, through resellers and distributors. Customers' decisions to purchase our products to deploy in commercial networks involve a significant commitment of resources and a lengthy evaluation, testing and product qualification process. We believe these long sales cycles, as well as our expectation that customers will

tend to sporadically place large orders with short lead times and the application of complex revenue recognition rules to certain transactions, may cause our revenues and results of operations to vary significantly and unexpectedly from quarter to quarter. We expect to recognize revenues from a limited number of customers for the foreseeable future.

Since our inception, we have incurred significant losses and, as of December 31, 2003, had an accumulated deficit of $808.6 million. Although we achieved profitability in the second quarter of fiscal 2002 and the fourth quarter of fiscal 2003, we have not achieved profitability on an annual basis and may incur additional net losses in future quarters and years. The quarterly net income in the second quarter of 2002 and the fourth quarter of 2003 was primarily the result of recognizing previously deferred revenue of $27.5 million and $10.9 million, respectively, from arrangements with a single customer. The previously deferred revenue was recognized as revenue upon the delivery of certain specified software releases in the second quarter of 2002 and the fourth quarter of 2003. We have a lengthy sales cycle for our products and, accordingly, we expect to incur sales and other expenses before we realize the related revenues. We expect to continue to incur significant sales and marketing, research and development and general and administrative expenses and, as a result, we will need to generate significant revenues to maintain profitability.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements and related disclosures requires management to make judgments, assumptions and estimates that affect the amounts reported in the consolidated financial statements and accompanying disclosures. Management bases its estimates and judgments on historical experience, market trends and other factors that are believed to be reasonable under the circumstances. On an on–going basis, we re–evaluate our estimates for changes in facts and circumstances, and material changes in these estimates could occur in the future if past experience or other assumptions do not turn out to be substantially accurate. Changes in estimates are recorded in the period in which they become known.

A summary of those accounting policies, significant judgments and estimates that we believe are most critical to fully understanding and evaluating our financial results is set forth below. This summary should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this report.

Revenue Recognition. We recognize revenues from product sales when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility of the related receivable is probable, unless we have future obligations, including a requirement to deliver additional elements which are essential to the functionality of the delivered elements or for which VSOE does not exist or customer acceptance is required, in which case the revenues and related costs are deferred until those obligations are satisfied or contingencies are resolved.

Many of our sales are generated from complex contractual arrangements, which require significant revenue recognition judgments, particularly in the case of multiple element arrangements. When a sale involves multiple elements, such as products, maintenance or professional services, we allocate the entire sales price to each respective element based on VSOE or using the residual method when VSOE cannot be established for one of the delivered elements in the arrangement. We then recognize revenues on each element in accordance with our policies for product and service revenue recognition. We determine VSOE based upon the price charged when the same element is sold separately. If we cannot establish VSOE for each undelivered element, we defer the entire contract revenues until the earlier of the establishment of VSOE or delivery of the undelivered element.

In addition, if an arrangement with a customer includes a specified upgrade right for which VSOE cannot be established, we defer all revenue related to the arrangement until the earlier of the delivery of the specified upgrade or the establishment of VSOE for the specified upgrade. In determining whether a specified upgrade right exists, we have concluded that if the specified upgrade is included in the customer contract or otherwise becomes part of the arrangement with the customer, then a specified upgrade right exists. We have concluded that communications with customers in the normal course of business regarding customer feature requests and our product plans do not create specified upgrade rights.

Maintenance and support services are recognized ratably over the life of the maintenance and support service period, which typically is one year when the services are sold separately and up to five years when bundled with the product fees. Maintenance and support services include telephone support and unspecified rights to product upgrades and enhancements. These services are typically sold for a one–year term and either are sold as part of a multiple element arrangement with products or are sold independently at time of renewal. Maintenance and support VSOE represents a consistent percentage of the sales prices charged to customers. The application of judgment could affect the continued determination of maintenance VSOE and our ability to recognize revenue using the residual method.

Installation service revenues are typically recognized at the time of the related product revenue recognition as installation is typically complete by the time of product revenue recognition. Professional services are recognized as the services are performed.

We sell the majority of our products directly to end–users. For products sold through resellers and distributors we recognize revenues on a sell–through method utilizing information provided to us from our resellers and distributors.

Product shipped to customers and related services where amounts are (1) billed pursuant to a contractual right and collection is probable, or (2) collected prior to satisfying the revenue recognition criteria are reflected as deferred revenues. Deferred revenues also include customer deposits and amounts associated with maintenance contracts, which are recognized on a straight–line basis over the related service periods, and free or discounted products and services not yet provided to customers. Deferred revenues not expected to be recognized within one year of the balance sheet date are classified as long–term deferred revenues.

We defer any incremental direct costs, such as inventory, royalties, commissions and third–party installation costs, incurred prior to satisfaction of our revenue recognition criteria and record them in proportion to revenue recognized.

Loss Contingencies. We are subject to ongoing business risks that affect the estimation process of the carrying value of assets, the recording of liabilities and the possibility of various loss contingencies, arising in the ordinary course of business. Under SFAS No. 5, an estimated loss contingency is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such amounts should be adjusted. Based on our analysis, we have established the following allowance and reserves:

Allowance for Doubtful Accounts. We establish billing terms at the time we negotiate purchase agreements with our customers. We continually monitor timely payments and assess any collection issues. The allowance for doubtful accounts is based on our detailed assessment of the collectibility of specific customer accounts. While we believe that our allowance for doubtful accounts is adequate and that the judgment applied is appropriate, if there is a deterioration of a customer's creditworthiness or actual defaults are higher than our historical experience, the actual results could differ from these estimates. While such credit losses have historically been within our expectations and the allowances we established, we cannot guarantee that we will continue to

experience the same credit loss rates that we have in the past. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payment, additional allowances may be required. Our failure to accurately estimate the losses for doubtful accounts and ensure that payments are received on a timely basis could have a material adverse effect on our business, financial condition and results of operations.

Inventory Reserves. Inventory purchases and commitments are based upon estimated future demand for our products. We value inventory at the lower of cost or net realizable value and provide inventory reserves based on excess and obsolete inventory determined primarily by future demand forecasts and record changes to such reserves through adjustments to cost of revenues. We assess such demand forecasts on at least a quarterly basis. If we record a charge to reduce inventory to its estimated net realizable value, we cannot increase its carrying value due to subsequent changes in demand forecasts. Accordingly, if inventory previously written down to its net realizable value is subsequently sold, we may realize improved gross profit margins on those transactions.

We also record a full inventory reserve for evaluation equipment at the time of shipment to our customers as a charge to sales and marketing expense as our experience with this type of inventory indicates it is probable that the inventory will not be realizable. If these evaluation shipments should convert to revenue, we record a benefit to sales and marketing expense and record the full cost of revenues in the period of revenue recognition.

We have experienced significant changes in our product demand and, as a result, our required inventory reserves have fluctuated in recent periods. As of December 31, 2003 and 2002, inventory of $13.7 million and $10.4 million was net of reserves of $13.8 million and $18.3 million. It is possible that significant changes in required inventory reserves may continue to occur in the future if there is a sudden and significant change in the demand for our products, changes in the amount of customer evaluation inventory or higher risks of inventory obsolescence because of rapidly changing technology.

Warranty Reserve. Our products are covered by a standard warranty of 90 days for software and one year for hardware. In addition, certain customer contracts include warranty–type provisions for epidemic or similar product failures generally for the contractual period or the life of the product in accordance with published telecommunications standards. We accrue for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. We have not incurred significant costs related to such provisions. Our customers typically purchase maintenance and support contracts, which encompass our warranty obligations. Our warranty reserve reflects estimated material and labor costs for potential or actual product issues in our installed base that are not covered under our maintenance contracts but for which we expect to incur an obligation. Our estimates of anticipated rates of warranty claims and costs are primarily based on historical information and future forecasts.

In addition, certain of our customer contracts include provisions under which we may be obligated to pay penalties generally for the contractual period or for the life of the product if our products fail or do not perform in accordance with specifications. We accrue for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. We have not incurred significant costs related to such provisions. We periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary. While we believe our warranty reserve is adequate to address known warranty issues, an increase in product failures rates, material usage or service delivery costs may result in an increase to our warranty reserve and our gross profit could be adversely affected.

Royalty Accrual. We accrue for royalties related to technology we license from vendors based on established royalty rates and usage. In certain cases, we have been contacted by third parties, who claim that our products infringe on certain intellectual property of the third party. We evaluate these claims and accrue for royalties when the amounts are probable and reasonably estimable. While we believe that the amounts accrued for estimated royalties are adequate, the amounts required to ultimately settle royalty obligations may be different.

Reserve for Litigation and Legal Fees. We are subject to various legal claims, including securities litigation and intellectual property claims. We reserve for legal contingencies and legal fees when the amounts are probable and reasonably estimable. Our director and officer liability insurance policies provide only limited liability protection relating to the securities class action and derivative lawsuits against us and certain of our officers and directors. We intend to defend these matters vigorously, although the ultimate outcome of these items is uncertain and the potential loss, if any, may be significantly higher or lower than the amounts we have previously accrued.

Accounting for Income Taxes. SFAS No. 109, *Accounting for Income Taxes*, requires the establishment of a valuation allowance to reflect the likelihood of realization of deferred tax assets. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We evaluate all available evidence, such as recent and expected future operating results by tax jurisdiction, and current and enacted tax legislation and other temporary differences between book and tax accounting, to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized.

As a result of net operating losses incurred in most jurisdictions in which we operate in the past, and uncertainty as to the extent, jurisdiction and timing of profitability in future periods, we have continued to record a full valuation allowance against deferred tax assets, which was approximately $104.7 million as of December 31, 2003. The establishment and amount of the valuation allowance requires significant estimates and judgment and can materially affect our results of operations. If the realization of deferred tax assets in the future is considered more likely than not, an adjustment to the deferred tax assets would increase net income in the period such determination was made. Our effective tax rate may vary from period to period based on changes in estimated taxable income or loss in each jurisdiction, changes to the valuation allowance, changes to federal, state or foreign tax laws, future expansion into areas with varying country, state and local income tax rates, deductibility of certain costs and expenses by jurisdiction and as a result of acquisitions.

Valuation of Long–Lived Assets. In accordance with SFAS No. 144, the carrying value of intangible assets and other long–lived assets is reviewed on a regular basis for the existence of facts or circumstances, both internally and externally, that may suggest impairment. Factors we consider important which could trigger an impairment review include:

- Significant underperformance relative to historical or projected future operating results;
- Significant negative industry or economic trends;
- Significant change in circumstances relative to a large customer;
- Significant decline in our stock price for a sustained period; and
- Our market capitalization relative to our net book value.

If such circumstances exist, we evaluate the carrying value of long–lived assets, other than goodwill, to determine if impairment exists based upon estimated undiscounted future cash flows over the remaining useful life of the assets and comparing that value to the carrying value of the assets. In determining expected future cash flows, assets are grouped at the lowest level for which cash flows are

identifiable and independent of cash flows from other asset groups. If the carrying value of the asset is greater than the estimated future cash flows, the asset is written down to its estimated fair value. The estimated undiscounted future cash flows and valuation of long–lived assets requires significant estimates and assumptions, including revenue and expense growth projections and fair value estimates such as estimated replacement cost and relief from royalty. These estimates contain management's best estimates, using appropriate and customary assumptions and projections at the time. If different estimates or assumptions are used, it is reasonably possible that our analysis would generate materially different results. As of December 31, 2003 and 2002, we had $2.4 million and $4.8 million of intangible assets. As of December 31, 2001 we had no remaining goodwill and thus were not subject to the transitional provisions of SFAS No. 142.

Stock–based Compensation. In October 1995, the FASB issued SFAS No. 123, *Accounting for Stock–Based Compensation*. SFAS No. 123 provides that companies may account for stock–based compensation under either the fair value–based method of accounting under SFAS No. 123 or the intrinsic value–based method provided by APB No. 25, *Accounting for Stock Issued to Employees*. We use the intrinsic value based method of APB No. 25 to account for all of our employee stock–based compensation plans and use the fair value method of SFAS No. 123 to account for all non–employee stock–based compensation. We follow FIN 28, and amortize the intrinsic value as measured under APB No. 25 on an accelerated basis. SFAS No. 123, as amended by SFAS No. 148, *Accounting for Stock–Based Compensation—Transition and Disclosure—an amendment of FASB Statement No. 123*, requires companies following APB No. 25 to make pro forma disclosure in the notes to the consolidated financial statements using the measurement provisions of SFAS No. 123.

Restructuring and Other Related Charges. We established exit plans for each of the restructuring activities which took place in 2001 and 2002 and accounted for these plans in accordance with Emerging Issues Task Force (EITF) Issue No. 94–3, *Liability Recognition for Certain Employee Benefits and Other Costs to Exit an Activity (including Certain Costs incurred in a Restructuring)*. These exit plans required that we make estimates as to the nature, timing and amount of the exit costs that we specifically identified. The consolidation of facilities required us to make estimates, which included contractual rental commitments or lease buy–outs for office space being vacated and related costs and leasehold improvement write–downs, offset by estimated sub–lease income. We have remaining accrued exit costs of $1,324,000 as of December 31, 2003, which relate to remaining lease payments. SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, was effective for exit or disposal activities that are initiated after December 31, 2002. SFAS No. 146 requires that a liability for a cost that is associated with an exit or disposal activity be recognized when the liability is incurred. A liability is recognized when the severance amounts relate to prior services rendered, the payment of the amount is probable and the amount can be reasonably estimated.

Results of Operations

Years Ended December 31, 2003 and 2002

Revenues. Revenues for the years ended December 31, 2003 and 2002 were as follows, in thousands:

	2003	2002
		As Restated
Revenues:		
Product	$ 60,851	$ 68,572
Service	32,359	25,345
Total revenues	$ 93,210	$ 93,917

Product revenues comprise sales of our voice infrastructure products, including our GSX9000™ Open Services Switch, the Insignus™ Softswitch, the Sonus Insight™ Management System and related product offerings. Product revenues for fiscal 2003 decreased 11% from fiscal 2002. In 2003, we had a lesser concentration of customers. In 2002, one customer represented 42% of revenues due to the deferral of revenue on product shipped during 2001. The related deferred revenue was recognized as revenue in 2002 upon the completion of the delivery of a specified software upgrade in the second quarter of 2002. Absent this, market conditions in 2003 for the sale of voice infrastructure products to telecommunications providers improved.

Service revenues primarily comprise hardware and software maintenance, network design and other professional services. Service revenues for fiscal 2003 increased 28% from fiscal 2002. The increase in service revenues was primarily due to an increase in maintenance revenue as a result of the growing installed customer base and the completion of significant professional services and installation projects during the year.

For the years ended December 31, 2003 and 2002, four customers and one customer each contributed more than 10% of our revenues, representing an aggregate of 57% and 42% of total revenues. International revenues, primarily from Asia and Europe, were 21% and 18% of revenues for the years ended December 31, 2003 and 2002.

The following customers contributed 10% or more of our revenues in the years ended December 31, 2003 and 2002:

Customer	2003	2002
Qwest Communications	18%	42%
Verizon Global Networks	15	*
AT&T Wireless Services	13	—
Global Crossing	11	*

* Represents less than 10% of revenues.

Our total deferred revenues for products were $47.9 million and $34.9 million as of December 31, 2003 and 2002. Our total deferred revenues for maintenance and support were $39.1 million and $24.8 million as of December 31, 2003 and 2002. The increase in deferred product revenue was attributable to timing and delivery and acceptance of customer orders. The increase in deferred revenues for maintenance and support was attributable to the growing installed customer base.

Cost of Revenues/Gross Profit. Our cost of revenues consists primarily of amounts paid to third party manufacturers for purchased materials and services, manufacturing and professional services personnel and related costs and inventory obsolescence. Manufacturing engineering, documentation control, final testing and assembly are performed at our facility. Cost of revenues and gross profit as a

percentage of revenues for the years ended December 31, 2003 and 2002 were as follows (in thousands, except percentages):

	2003	2002
		As Restated
Cost of revenues:		
Product	$ 23,575	$ 33,573
Service	14,334	11,873
Write–off of inventory and purchase commitments	—	6,130
Total cost of revenues	$ 37,909	$ 51,576
Gross profit (% of respective revenues):		
Product	61%	51%
Service	56	53
Total gross profit	59	45(1)

(1) Includes the impact of a $6.1 million charge for the write–off of inventory and purchase commitments.

The increase in product gross profit as a percentage of revenues, excluding the write–offs, was primarily due to a greater proportion of revenues of higher margin software as well as the benefit resulting from the sale of inventory previously written down of $5.6 million. In 2002, included in cost of product revenues is $3.0 million for technology and intellectual property licensing related to our products. The increase in service gross profit as a percentage of revenues was primarily due to our ability to leverage scalability of our service organization to fulfill customer service functions.

Research and Development Expenses. Research and development expenses consist primarily of salaries and related personnel costs and prototype costs related to the design, development, testing and enhancement of our products. Research and development expenses were $32.2 million for fiscal 2003, a decrease of $12.4 million, or 28%, from $44.6 million in fiscal 2002. The decrease primarily reflects a reduction in staffing levels and related expenses attributable to restructuring actions and depreciation expense, partially offset by the cessation in April 2003 of a temporary salary reduction imposed in April 2002. Rapid technological innovation is critical to our long–term success and we intend to continue to make substantial investments to enhance our products and technologies to meet the requirements of our customers and market. Accordingly, we believe that our research and development expenses for fiscal 2004 will increase from fiscal 2003 primarily as a result of additional hiring due to the continuing expansion of our product lines, particularly our access products, and customer demand.

Sales and Marketing Expenses. Sales and marketing expenses consist primarily of salaries and related personnel costs, commissions, travel and entertainment expenses, promotions, customer evaluations and other marketing expenses. Sales and marketing expenses were $23.2 million for fiscal 2003, a decrease of $4.6 million, or 17%, from $27.8 million in fiscal 2002. The decrease primarily reflects a reduction in staffing levels and related expenses attributable to restructuring actions partially offset by the cessation in April 2003 of a temporary salary reduction imposed in April 2002. We believe that our sales and marketing expenses in fiscal 2004 will increase modestly from the fiscal 2003 level primarily as a result of an increase in hiring due to the expansion of our international operations and forecasted higher commissions attributable to increased sales volumes.

General and Administrative Expenses. General and administrative expenses consist primarily of salaries and related personnel costs for executive and administrative personnel, recruiting expenses, allowance for doubtful accounts and professional fees. General and administrative expenses were $10.5 million for fiscal 2003, an increase of $5.3 million, or 100%, from $5.2 million in fiscal 2002. The increase primarily reflects a $4.6 million increase in independent registered public accounting firm audit fees incurred related to our restatements. We believe that our general and administrative expenses in fiscal 2004 will increase materially from the fiscal 2003 level primarily as a result of additional professional fees incurred as part of our investigation, the SEC investigation and securities class action litigation, and for costs associated with improvements we expect to make in our internal control environment to remedy material weaknesses and to meet the requirements of Section 404 of the Sarbanes–Oxley Act of 2002.

Stock–based Compensation Expenses. Stock–based compensation expenses include the amortization of deferred stock–based compensation resulting primarily from the granting of stock options and stock awards to TTI employees under the 2000 Retention Plan and sales of restricted common stock in connection with our acquisition of TTI. The compensation expense associated with non–employees is recorded at the time services are provided. As of December 31, 2003, we expect to record approximately $564,000 in employee stock based compensation expense for fiscal 2004.

Stock–based compensation expenses were $3.4 million for fiscal 2003, a decrease of $13.5 million, or 80%, from $16.9 million in fiscal 2002. The decrease is primarily attributable to lower deferred compensation balances resulting from normal amortization, calculated on the accelerated model under FIN 28 as described in Note 1 (m) to our consolidated financial statements, as well as write–offs made in connection with employee terminations and our offer to exchange certain employee stock options in October 2002 described below, which resulted in a charge of $562,000.

On October 16, 2002, we commenced an offer to exchange (Exchange Offer) outstanding employee stock options for new stock options to be granted on a date that is at least six months and one day from the expiration date of the Exchange Offer. The Exchange Offer expired on November 22, 2002, and outstanding options to purchase approximately 8,973,000 shares of common stock were accepted for exchange and cancelled. On May 27, 2003, employees received an option to purchase one share of common stock for each share of common stock under the exchanged options at an exercise price of $4.08 per share, representing the fair market value of our common stock on the date of grant.

Goodwill, Purchased Intangible Assets and In–Process Research and Development Expenses. In fiscal 2001, we acquired certain intellectual property, in–process research and development and intangible assets in connection with our acquisitions of TTI and Linguateq. Amortization of purchased intangible assets was $2.4 million for fiscal 2003, a decrease of $1.8 million, or 43%, from $4.2 million for fiscal 2002. In the third quarter of fiscal 2002, in accordance with SFAS No. 142, in response to unfavorable business conditions, we re–evaluated the fair value of our goodwill and as a result recorded a non–cash impairment charge of $10.9 million for the write–off of goodwill established in connection with the acquisitions of TTI and Linguateq. The decrease in amortization expenses for 2003 is due to the write–off of certain purchased intangibles in fiscal 2002. We expect to recognize amortization expense of $2.4 million in fiscal 2004 for the remaining value of the intangible assets.

Restructuring Charges, net. Commencing in the third quarter of fiscal 2001 and extending through fiscal 2002, in response to unfavorable business conditions primarily caused by significant reductions in capital spending by telecommunications service providers, we implemented restructuring actions designed to reduce expenses and align our cost structure with our revised business outlook. The restructuring actions included worldwide workforce reductions, consolidation of excess facilities and the write–off of inventory and purchase commitments. See Note 3 to our consolidated financial statements.

Workforce reduction. In fiscal 2002, we reduced our worldwide work force for which we recorded a charge of $5.3 million. As of December 31, 2003, all cash expenditures had been made related to this reduction.

Consolidation of excess facilities. In fiscal 2002, we recorded a net restructuring charge of $2.5 million for the additional consolidation of excess facilities, of which $1.0 million was paid in 2002 and $1.1 million was paid in 2003. As of December 31, 2003, we expected to pay the remaining $1.1 million relating to the consolidation of excess facilities through 2008.

Write–off of inventory and purchase commitments. In fiscal 2002, we recorded net charges to cost of revenues of $6.1 million, consisting of $4.5 million for excess and obsolete inventory and $1.6 million for purchase commitments that were in excess of required quantities. The charge for purchase commitments was recorded on the balance sheet as accrued restructuring expenses.

Interest Income (Expense), net. Interest income consists of interest earned on our cash balances and marketable securities. Interest expense consist of interest incurred on convertible subordinated notes, equipment financing and capital lease arrangements. Interest income, net of interest expense, was $1.5 million for fiscal 2003, an increase of $200,000 from $1.3 million in fiscal 2002. The increase reflects an increase in our cash and investments balances from our completed public offerings in April and September 2003.

Net Operating Loss Carryforwards. As of December 31, 2003, we had approximately $190.0 million of federal net operating loss carryforwards for tax purposes available to offset future taxable income. These net operating loss carryforwards expire at various dates through 2023, to the extent that they are not used. We have not recognized any benefit from the future use of net operating loss carryforwards for fiscal 2003 and 2002, or for any other periods since inception. Use of the net operating loss carryforwards may be limited in future years if there is a significant change in our ownership. We have recorded a full valuation allowance for the related net deferred tax asset due to the uncertainty of realizing the benefit of this asset.

Income Taxes. We have provided $302,000 in 2003 and $86,000 in 2002 for foreign income taxes and state minimum taxes in the United States.

Years Ended December 31, 2002 and 2001

Revenues. Revenues for the years ended December 31, 2002 and 2001 were as follows, in thousands:

	2002	2001
	As Restated	**As Restated**
Revenues:		
Product	$ 68,572	$ 104,646
Service	25,345	24,154
Total revenues	$ 93,917	$ 128,800

Product revenues for fiscal 2002 decreased 34% from fiscal 2001. The decrease in product revenues was the result of significant declines in capital spending by telecommunications service providers and financial difficulties, including in some cases bankruptcies, experienced by certain emerging service providers, including some of our customers. In 2002, one customer represented 42% of revenues, which were primarily related to the delivery of a specified software upgrade in 2002 from a shipment completed in 2001. Service revenues for fiscal 2002 increased 5% from fiscal 2001 primarily due to a greater installed base of products under maintenance contracts and an increase in product installation revenues.

The following customers contributed 10% or more of our revenues in the years ended December 31, 2002 and 2001:

Customer	2002	2001
Qwest Communications	42%	—%
Nissho Electronics Corporation	*	21
XO Communications	*	21
Global Crossing	*	18

* Represents less than 10% of revenues.

Cost of Revenues/Gross Profit. Cost of revenues and gross profit as a percentage of revenues for the years ended December 31, 2002 and 2001 were as follows (in thousands, except percentages):

	2002	2001
	As Restated	As Restated
Cost of revenues:		
Product	$ 33,573	$ 43,717
Service	11,873	19,061
Write-off of inventory and purchase commitments	6,130	—
Total cost of revenues	$ 51,576	$ 62,778
Gross profit (% of respective revenues):		
Product	51%	58%
Service	53	21
Total gross profit	45(1)	51

(1) Includes the impact of a $6.1 million charge for the write-off of inventory and purchase commitments.

The decrease in product gross profit as a percentage of revenues, excluding the write-offs, was primarily due to a higher proportion of fixed costs resulting from the significant decline in revenue as well as $3.0 million for technology and intellectual property licensing related to our products in 2002. The increase in service gross profit as a percentage of revenues was primarily due to cost-cutting measures attributed to our restructuring actions.

Research and Development Expenses. Research and development expenses were $44.6 million for fiscal 2002, a decrease of $19.3 million, or 30%, from $63.9 million in fiscal 2001. The decrease primarily reflects a reduction in salaries, related expenses attributable to restructuring actions and, to a lesser extent, reductions in consulting fees and prototype costs.

Sales and Marketing Expenses. Sales and marketing expenses were $27.8 million for fiscal 2002, a decrease of $13.1 million, or 32%, from $40.9 million in fiscal 2001. The decrease primarily reflects a reduction in salaries and related expenses attributable to restructuring actions and a reduction in commissions due to the decline in revenues, partially offset by increased costs for customer evaluation equipment.

General and Administrative Expenses. General and administrative expenses were $5.2 million for fiscal 2002, a decrease of $7.6 million, or 59%, from $12.8 million in fiscal 2001. The decrease primarily reflects reductions in salaries and related expenses attributable to restructuring actions, consultants and a reduction in the provision for doubtful accounts, and, to a lesser extent, reductions in travel and entertainment and supplies.

Stock-based Compensation Expenses. Stock-based compensation expenses were $16.9 million for fiscal 2002, a decrease of $57.2 million, or 77%, from $74.1 million in fiscal 2001. The decrease is primarily attributable to lower deferred compensation balances resulting from normal amortization, calculated on the accelerated model under FIN 28 as described in Note 1 (m) to our consolidated

financial statements, write–offs made in connection with employee terminations and our offer to exchange certain employee stock options.

Goodwill, Purchased Intangible Assets and In–Process Research and Development Expenses. In January 2001, we acquired certain intellectual property, in–process research and development and intangible assets in connection with our acquisition of TTI, which resulted in the recording of $520.6 million of goodwill and other intangibles. Results for fiscal 2001 included a $40.8 million write off of TTI purchased in–process research and development. Amortization of TTI purchased intangible assets was $3.9 million for fiscal 2002, a decrease of $66.5 million from $70.4 million for fiscal 2001. This decrease is primarily the result of a write–off of $392.4 million of TTI goodwill and purchased intangible assets in fiscal 2001. See Notes 4 and 5 to our consolidated financial statements.

In July 2001, we completed the acquisition of certain intellectual property and other assets of privately–held Linguateq, a provider of data distribution and billing application software, which resulted in the recording of $5.2 million of goodwill and purchased intangible assets. Results for fiscal 2001 included a non–cash charge of $3.8 million for purchased in–process research and development. Amortization of Linguatec purchased intangible assets was $358,000 for fiscal 2002, an increase of $191,000 from $167,000 for fiscal 2001. See Note 6 to our consolidated financial statements.

Write–Off of Goodwill and Purchased Intangible Assets. In response to unfavorable business conditions, we re–evaluated the fair value of goodwill established in connection with the acquisitions of TTI and Linguatec and as a result recorded a non–cash impairment charge of $11.0 million in fiscal 2002 for the write–off of goodwill.

In fiscal 2001, in light of negative industry and economic conditions, a general decline in technology valuations and our decision to discontinue the development and use of certain acquired technology, we performed an assessment of the carrying value of the goodwill and purchased intangible assets recorded in connection with our acquisition of TTI. In accordance with SFAS No. 121, we recorded a non–cash impairment charge of $392.4 million in fiscal 2001 for the write–off of goodwill and certain purchased intangible assets because the estimated undiscounted future cash flows of these assets was less than the carrying value.

Restructuring Charges, net. Commencing in the third quarter of fiscal 2001 and continuing through fiscal 2002, in response to unfavorable business conditions primarily caused by significant reductions in capital spending by telecommunications service providers, we implemented restructuring actions designed to reduce expenses and align our cost structure with our revised business outlook. The restructuring actions included worldwide workforce reductions, consolidation of excess facilities and the write–off of inventory and purchase commitments. See Note 3 to our consolidated financial statements.

Workforce reduction. Restructuring actions in fiscal 2001 resulted in the reduction of our work force by approximately 150 employees, or 21%. Restructuring actions in fiscal 2002 reduced the work force by an additional 230 employees, or 39%. The affected employees were entitled to severance and other benefits for which we recorded charges of $5.3 million in fiscal 2002 and $3.5 million in fiscal 2001.

Consolidation of excess facilities and other charges. We recorded net restructuring charges of $2.5 million and $3.8 million in fiscal 2002 and 2001 for the consolidation of excess facilities and other miscellaneous charges, which are included on the balance sheet as accrued restructuring expenses and long–term obligations.

Write–off of inventory and purchase commitments. During fiscal 2002, we recorded charges to cost of revenues of $6.1 million, consisting of $4.5 million for excess and obsolete inventory and $1.6 million for purchase commitments that are in excess of required quantities.

Interest Income (Expense), net. Interest income consists of interest earned on our cash balances and marketable securities. Interest expense consists of interest incurred on convertible subordinated notes, equipment financing and capital lease arrangements. Interest income, net of interest expense, was $1.3 million for fiscal 2002, a decrease of $3.6 million from $4.9 million in fiscal 2001. The decrease primarily reflects a reduction in interest rates and average invested balances.

Income Taxes. We have provided $86,000 in 2002 for foreign income taxes and state minimum taxes in the United States. No amounts for income taxes had been provided for fiscal 2001, due to accumulated net losses.

Off–Balance Sheet Arrangements

We have no off–balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Liquidity and Capital Resources

At December 31, 2003, our principal source of liquidity was our cash, cash equivalents and marketable securities that totaled $305.4 million. In September 2003, we completed a public offering of 17,000,000 shares of our common stock at a price of $7.75 per share resulting in net proceeds of $126.1 million after deducting offering costs of $5.7 million. In April 2003, we completed a public offering of 20,000,000 shares of our common stock at a price of $3.05 per share, resulting in net proceeds of $56.7 million after deducting offering costs of $4.3 million.

Our operating activities provided net cash of $4.8 million in fiscal 2003, as compared to net cash used of $8.5 million in fiscal 2002. Net cash provided by operating activities in 2003 was attributable primarily to an increase in deferred revenue of $27.2 million, non–cash expense items of $15.5 million, offset in part by a net loss of $15.1 million, an increase in accounts receivable of $19.1 million and an increase in other working capital accounts of $3.7 million.

Net cash used in investing activities was $114.8 million for fiscal 2003, as compared to net cash provided by $11.6 million for fiscal 2002. Net cash used by investing activities for fiscal 2003 primarily reflects net purchases of marketable securities of $110.8 million resulting from the proceeds of our public offerings of common stock completed in April and September 2003, in addition to purchases of property and equipment of $3.2 million. Net cash provided by investing activities for fiscal 2002 primarily reflects net maturities of marketable securities of $15.1 million, partially offset by purchases of property and equipment of $3.4 million. We have no current material commitments for capital expenditures but do expect approximately $7.0 to $10.0 million in capital expenditures during fiscal 2004.

We had a $10.0 million equipment line of credit and a $20.0 million working capital line of credit with a bank available through March 23, 2004. We did not renew the lines of credit upon their expiration. As of December 31, 2003, we had no amounts outstanding under the equipment line of credit. See Note 11 to our consolidated financial statements.

Net cash provided by financing activities was $186.4 million for fiscal 2003, as compared to $5.1 million for fiscal 2002. The net cash provided by financing activities for fiscal 2003 primarily resulted from the net proceeds of $182.8 million from the public offerings of common stock completed in April and September 2003 as well as $6.9 million from the sale of common stock in connection with stock option exercises and our employee stock purchase plan, offset by payments of $3.4 million on the equipment line of credit. The net cash provided by financing activities for fiscal 2002 primarily resulted from proceeds of $3.0 million from the sale of common stock in connection with stock option exercises and our employee stock purchase plan and net borrowings on our bank equipment line of credit.

The following summarizes our future contractual obligations as of December 31, 2003, in thousands:

	Payment Due By Period				
	Total	Less than 1 year	1–3 years	3–5 years	More than 5 years
Contractual Obligations:					
Long–term debt obligations	$ 11,188	$ 475	$ 10,713	$ —	$ —
Capital lease obligations	219	189	30	—	—
Operating lease obligations	4,111	1,693	2,205	213	—
Total	$ 15,518	$ 2,357	$ 12,948	$ 213	$ —

Based on our past performance and current expectations, we believe our current cash, cash equivalents and marketable securities will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least 12 months. Although it is difficult to predict future liquidity requirements with certainty, the rate at which we will consume cash will be dependent on the cash needs of future operations, including changes in working capital, which will, in turn, be directly affected by the levels of demand for our products, the timing and rate of expansion of our business and the resources we devote to developing our products. We anticipate devoting substantial capital resources to continue our research and development efforts, to maintain our sales, support and marketing, and for other general corporate activities, as well as to vigorously defend against existing and potential litigation and resolve pending or potential investigations relating to the restatement of our consolidated financial statements. See Note 13 to our consolidated financial statements.

Recent Accounting Pronouncements

In November 2002, the FASB issued FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of the interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002 and the disclosure requirements in this interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The FIN 45 disclosure requirements are included in Note 8(c) to our consolidated financial statements. The adoption of FIN 45 did not have a material impact on our financial position or results of operations.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities* and, in December 2003, issued a revision to that interpretation (FIN 46R). FIN 46R replaces FIN 46 and addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity (VIE) is defined as (a) an ownership, contractual or monetary interest in an entity where the ability to influence financial decisions is not proportional to the investment interest, or (b) an entity lacking the invested capital sufficient to fund future activities without the support of a third party. FIN 46R establishes standards for determining under what circumstances VIEs should be consolidated with their primary beneficiary, including those to which the usual condition for consolidation does not apply. We currently do not have any variable interest entities.

In May 2003, the FASB issued SFAS No. 150, *Accounting For Certain Financial Instruments with Characteristics of Both Liabilities and Equity,* which establishes standards for how an issuer of financial instruments classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope

as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have any impact on our overall financial position or results of operations.

In August 2003, the EITF reached a consensus on Issue No. 03–05, *Applicability of AICPA Statement of Position 97–2 to Non–Software Deliverables in an Arrangement Containing More–Than–Incidental Software.* EITF Issue No. 03–05 addresses the applicability of SOP 97–2 to non–software deliverables in an arrangement containing more–than–incidental software. In an arrangement that includes software that is more–than–incidental to the products or services as a whole, software and software–related elements are included within the scope of SOP 97–2. Software–related elements include software products and services, as well as any non–software deliverables for which a software deliverable is essential to its functionality. The adoption of this statement did not have a material impact on our consolidated financial results.

In December 2003, the staff of the SEC issued Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition,* which supersedes SAB No. 101, *Revenue Recognition in Financial Statements.* SAB No. 104's primary purpose is to rescind the accounting guidance contained in SAB No. 101 related to multiple–element revenue arrangements that was superseded as a result of the issuance of EITF Issue No. 00–21, *Accounting for Revenue Arrangements with Multiple Deliverables.* Additionally, SAB No. 104 rescinds the SEC's related *Revenue Recognition in Financial Statements Frequently Asked Questions and Answers* issued with SAB No. 101 that had been codified in SEC Topic 13, *Revenue Recognition.* While the wording of SAB No. 104 has changed to reflect the issuance of EITF 00–21, the revenue recognition principles of SAB No. 101 remain largely unchanged by the issuance of SAB No. 104, which was effective upon issuance. We adopted the provisions of SAB No. 104 in the fourth quarter of 2003. Our adoption of SAB No. 104 did not have a material effect on its financial position or results of operations.

Explanation of Use of Non–GAAP Financial Results

In addition to our audited financial results in accordance with United States generally accepted accounting principles (GAAP), to assist investors in light of the restatements for prior periods, we may on occasion provide certain non–GAAP financial results as an alternative means to explain our periodic results. The non–GAAP financial results typically may exclude non–cash or one–time charges or benefits.

Our management uses the non–GAAP financial results as an alternative means for assessing internally our quarterly operations. By excluding non–cash charges such as stock–based compensation, amortization of goodwill and purchased intangible assets, write–off of goodwill and purchased intangible assets and in–process research and development expenses, our management can evaluate our operations excluding these non–cash charges and can compare its results on a more consistent basis to the results of other companies in our industry. By excluding one–time charges such as restructuring charges (benefits) and inventory write–offs, our management can compare our ongoing operations to prior quarters where such items may be materially different and to ongoing operations of other companies in our industry who may have materially different one–time charges. Even though our management recognizes that non–GAAP financial results are not a substitute for GAAP results, non–GAAP measures are helpful in assisting our management in understanding and managing our business.

Our management believes that the non–GAAP financial results may also provide useful information to investors. Non–GAAP results may also allow investors and analysts to more readily compare our operations to prior financial results and to the financial results of other companies in the industry who similarly provide non–GAAP results to investors and analysts. Investors may seek to evaluate our business performance and the performance of our competitors as they relate to cash. Excluding one–time and non–cash charges may assist investors in this evaluation and comparisons.

We intend to continue to assess the potential value of reporting non–GAAP results consistent with applicable rules and regulations.